

**STATE OF NEW JERSEY  
BOARD OF PUBLIC UTILITIES**

<b>In The Matter Of Focused Audit of</b>	<b>:</b>	
<b>Elizabethtown Gas Company, NUI</b>	<b>:</b>	<b>DOCKET NO: GA03030213</b>
<b>Utilities, Inc. and NUI Corporation</b>	<b>:</b>	

**COMMENTS OF NUI CORPORATION, NUI UTILITIES, INC. AND  
ELIZABETHTOWN GAS COMPANY TO REPORT OF THE  
LIBERTY CONSULTING GROUP DATED MARCH 1, 2004**

These comments are submitted to the New Jersey Board of Public Utilities ("Board" or "BPU") on behalf of NUI Corporation ("NUI") and its wholly-owned subsidiary NUI Utilities, Inc. ("NUI Utilities"), which includes Elizabethtown Gas Company ("ETG"), in response to the audit report of The Liberty Consulting Group ("Liberty") accepted by the Board on March 17, 2004.

As was the case with Liberty's interim report, which NUI responded to in December 2003, NUI disagrees with a number of Liberty's recommendations, conclusions and characterizations of historical events. However, at this juncture in what has been a year-long process since the BPU first announced its intent to conduct a focused audit, many of these disagreements have been rendered moot by subsequent events, as Liberty itself repeatedly notes. In many instances, NUI does not agree with Liberty's recommendation and/or the basis for it, but will accept it for the sole purpose of settling this proceeding. However, where NUI believes that the recommendations are both material and inappropriate, NUI will continue to challenge them.

NUI believes that the most useful recommendation that the Board could adopt in this proceeding is as follows:

***The BPU should permit NUI to stay its current course and complete the efforts it commenced last year, including the process to sell the Company.***

NUI and the BPU Staff have been engaged in settlement discussions since the interim report was issued in December. NUI continues to believe it to be in the best interests of all affected constituents --

the BPU, NUI, its customers, employees and shareholders -- to resolve the outstanding issues in this proceeding through a comprehensive settlement and move expeditiously to complete the sales process. A comprehensive settlement of this matter will save money, BPU resources and provide the clearest path to the successful conclusion of the sales process.

In preparing these comments, NUI is mindful of the fact that both its internal investigation and the Audit Report have concluded that NUI Utilities has a significant refund liability to its customers. NUI recognizes that it faces a challenge to restore the confidence of its customers, regulators and investors, as well as to revitalize the morale of its employees. NUI is committed to this effort. NUI has worked hard, and will continue to work hard, to ensure that the conditions giving rise to this liability will not recur. Moreover, NUI has worked diligently and made changes designed to upgrade its management and financial controls. Specifically, NUI has accomplished, or is in the process of accomplishing, the following:

- NUI has a new President and Chief Executive Officer, Craig Matthews, who comes to NUI with many years of experience in the natural gas utility industry. Robert Kenney, a former President and CEO of ETG and a member of the ETG Advisory Board, currently serves on both the NUI and the NUI Utilities' Boards of Directors. NUI also has a new General Counsel, Steven Overly.
- The Board of Directors of NUI and NUI Utilities now have three overlapping members.
- Following John Kean's retirement on April 1, 2004, James Forese will become Chairman of the Board of NUI.
- NUI and NUI Utilities entered into separate, unsecured credit facilities aggregating \$405 million on November 24, 2003. These facilities, arranged by Credit Suisse First Boston ("CSFB"), supported the gas distribution systems during the current winter heating season and will continue to do so, and provide the financial flexibility and necessary support during the process of selling NUI.
- From the proceeds of the CSFB financing going to NUI, \$85 million was immediately downstreamed to NUI Utilities to repay the intercompany receivable in full, including the portion

previously reflected on NUI Utilities' fiscal 2002 audited financial statements as a reduction in shareholders' equity.

- The prior NUI and NUI Utilities credit facilities arranged by Fleet Bank and the NUI Senior Notes, which contained covenants that Liberty has criticized, have been repaid in full with the proceeds from the CSFB financing.
- Even before Liberty had finalized its interim report, NUI took steps to alter its cash pooling program, and NUI Utilities' cash is no longer held in a common cash pool with the cash of its parent.
- NUI Utilities has an expanded Board with a majority of independent Directors. A number of the Directors who are anticipated to continue to serve until the sale is completed (Craig Matthews, Robert Kenney, and Duncan Ellsworth) have had long and distinguished careers in the gas utility business.
- A capital budget for fiscal year 2004 has been approved at a level that continues to provide full funding for ETG's capital needs.
- NUI is well along in the process of exiting its non-core businesses.
- NUI Utilities' natural gas procurement and asset management activities were outsourced to an independent third party in January, 2004, and a competitive bidding process is being conducted to select an asset manager for a 12-month period commencing on or about April 1, 2004.
- The NUI dividend has been cut to further strengthen NUI's financial position.
- A preeminent independent investigator was engaged to examine certain transactions at NUIEB and is nearing completion of its report.
- NUI's Board of Directors is continuing its efforts to sell the Company.
- **Throughout this entire period, ETG has continued and will continue to provide safe, adequate and proper service to its customers at just and reasonable rates.**

The efforts to implement many of these steps were initiated by NUI either before Liberty's work began, or before Liberty had finalized its report. Moreover, even though NUI has needed to expend

considerable effort and expense to attain these accomplishments, the BPU should keep in mind that *none* of the extraordinary expenses related to these efforts are included in ETG's current rates.

It is NUI's desire to resolve this proceeding as quickly as possible in order to enable NUI to focus on the sale of the Company. To that end, NUI's comments herein will focus on two areas that create the most significant obstacles to the resolution of this proceeding and have not been addressed in detail by NUI in its previous comments in this proceeding. Those areas are:

(1) a disagreement over the damages incurred by NUI Utilities as a result of NUIEB's conduct of ETG's gas supply and upstream capacity management function as discussed in Chapter Six of the Audit Report;

(2) a disagreement over the treatment of certain costs incurred and benefits realized by NUIEB and NUI Utilities as a result of (i) a contract between Enron Corporation ("Enron") and NUI Utilities in the Spring of 2001 that permitted ETG to purchase quantities of gas needed to refill storage and provided for the deferred payment of the costs of such gas to Enron in return for what, at the time the contract was entered into, was an above-market price, (ii) concurrent action by NUIEB in arranging a swap transaction with Enron that enabled NUIEB to significantly reduce the cost of gas incurred by ETG under its agreement with Enron, and (iii) the subsequent settlement between NUI, NUI Utilities and Enron that enabled NUIEB to obtain recovery of payments owed to various NUI affiliates and to realize a significant additional discount in return for the accelerated payment of the amounts owed by ETG under the storage-fill sales agreement.

As discussed more fully below, in an effort to resolve this proceeding, NUI Utilities is willing to make significant refunds to its customers. NUI also wishes to conduct further settlement discussions with the Board's Staff in order to determine if further agreements can be reached that will resolve this proceeding in a comprehensive fashion. To the extent that such a resolution is not possible, as a last resort, NUI requests a limited, expedited evidentiary hearing to resolve the following recommendations which continue to be at issue between NUI and Liberty:

(1) the appropriate level of refunds to be made by ETG as a result of NUIEB's capacity management activities on behalf of ETG;

(2) the appropriate level of refunds to be made by ETG as a result of NUIEB's sales to ETG through auctions conducted by East Coast Natural Gas Cooperative;

(3) the appropriate level of refunds to be made by ETG as a result of its entering into a deferred gas payment arrangement with Enron in 2001 and NUIEB's subsequent efforts to offset the costs incurred under that arrangement;

(4) the appropriate treatment of the discount obtained by NUIEB under its settlement with Enron in 2001;

(5) whether it is appropriate to require ETG to refund amounts associated with Liberty's determination that the equity component of ETG's capital structure was inappropriately reduced during the period December, 2002 through November, 2003, and that therefore a different utility capital structure should be retroactively imposed on ETG which would require refunds to customers; and

(6) other issues that involve retroactive rate adjustments or refunds to customers.

NUI cannot emphasize enough its desire to resolve this matter quickly and without further proceedings so that NUI can proceed with the process to sell the Company. Nonetheless, in the unlikely event that other forms of resolutions are unsuccessful, NUI must request an evidentiary hearing to enable it to protect its own and its shareholders' legitimate interests.

The comments set forth below are structured as follows:

(1) First, the recommendations set forth in Chapter 6 of the Audit Report concerning NUI Utilities' relationship with its energy affiliates will be addressed;

(2) Second, the recommendations set forth in Chapter 4 will be discussed; and

(3) Third, the recommendations set forth in Chapters 3, 5, 7 and 8 will be addressed.

#### **Recommendation VI-1. Outsource NUI Utilities' Gas Supply Management Function.**

NUI Utilities has entered into an arrangement with NJR Energy Services, Inc. ("NJR") under which NJR acts as agent for NUI Utilities for gas supply procurement and capacity management services.

This arrangement is for a term that commenced in January, 2004 and will expire March 31, 2005 unless terminated sooner. This arrangement was approved by the BPU by order dated January 14, 2004<sup>1</sup> subject to the condition that NUI Utilities should conduct an open and competitive bid for its gas supply and capacity management services for the period commencing April 1, 2004. NUI Utilities instituted a process for receiving bids for gas supply and capacity management services and has received and reviewed multiple bids from nine third-party suppliers. As a result of this process, NUI Utilities has selected a bidder with whom it is attempting to negotiate a contract to commence on or about April 1, 2004.

In terms of the resolution of the issues raised in the Audit Report, the bids received by NUI Utilities demonstrate that (1) the historical margins generated by NUIEB for the various elements of NUI Utilities' portfolio are generally in excess of the fixed payments bid by third-party suppliers, and (2) third party suppliers were generally unwilling to manage NUI Utilities' portfolio for less than the 15% sharing of margins from off-system sales and capacity release credits that the Board currently permits NUI Utilities to retain.

NUI Utilities' request for proposals involved a bid for four elements of NUI Utilities' upstream capacity portfolio: (1) the ETG capacity portfolio, which is used to supply BGSS customers, (2) the Florida portfolio, (3) the Maryland portfolio, and (4) NUI Utilities' contract with Transcontinental Gas Pipe Line Corporation ("Transco") for Rate Schedule WSS storage service,<sup>2</sup> the costs of which are currently borne solely by NUI Utilities' shareholder. While analysis of the bids is complex, NUI Utilities believes that it can demonstrate that none of the bids value the ETG regulated portfolio at a level that is greater than the level of secondary market margin generated by NUIEB during the 2000-2002 period.<sup>3</sup> Moreover, the bids for the ETG-regulated portion of the portfolio do not approach the level of margins

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<sup>1</sup> *I/M/O The Focused Audit Of ETG Gas Company, NUI Utilities, Inc. and NUI Corporation*, Docket No. GA03030213 (January 14, 2004).

<sup>2</sup> This contract is discussed more fully below.

<sup>3</sup> The average of these three years, based on the information contained on page VI-62 of the Audit Report, is approximately \$2.552 million. As discussed more fully below, NUIEB's ability to generate margins/credits from off-system sales during the 2000-2002 period was significantly affected by the level of on-system, non-firm sales being made during this period; a factor overlooked or ignored by Liberty.

generated by NUIEB in fiscal year 2003.<sup>4</sup> While a comparison of secondary market results from different historical periods is, to some extent, a comparison of apples and oranges, it is worthy of consideration in light of the assertions in Liberty's report that NUIEB did a poor job of managing ETG's secondary market transactions.

While NUI Utilities believes that the bidder with whom NUI Utilities has commenced contract negotiations has put forth a bid that is consistent with NUI Utilities' valuation of its total portfolio for the period April 1, 2004 through March 31, 2005, the fact of the matter is that the bids received by NUI Utilities provide it with no reason to believe, based on NUIEB's past performance, that NUIEB would have achieved results that were worse than that determined through a competitive bidding process. Moreover, to the extent that the bids can be compared to NUIEB's performance in historical periods, it is readily apparent that the bids do not support Liberty's assertion that NUIEB performed less-than-competently in administering ETG's off-system transactions.

**Recommendation VI-2. Reimburse Customers Through The BGSS Mechanism \$1.2 Million for Margins That NUIEB Derived From Selling Gas To ETG Through The Co-Op.**

Liberty asserts that NUIEB should not have sold gas to NUI Utilities through the East Coast Natural Gas Cooperative ("Co-op"). Liberty asserts that ETG should be required to refund to BGSS customers \$1,159,000 associated with such sales. Liberty's damages calculation is based on its calculation of the average margin earned by NUIEB on volumes of gas it sold in 2002. In other words, Liberty has simply assumed that NUIEB earned a margin on sales to NUI Utilities through the Co-op that is equivalent to the margins earned from all other sales.

At the outset, it is worth noting that there is no law or regulatory policy in the State of New Jersey that precludes or even discourages an affiliated supplier from selling gas to an affiliate at a profit. On the contrary, N.J.S.A. 48:3-58(r) provides that gas supplies procured by a utility to serve BGSS customers must be secured at prices consistent with market conditions. Moreover, under the BPU's regulations governing the transfer of services purchased on the open market by a related competitive business

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<sup>4</sup> Off-system margins and credits for fiscal year 2003, as set forth in the Audit Report at VI-62, totaled \$4.229 million.

segment of a public utility holding company to a public utility, the price of such services may be “no more than fair market value.”<sup>5</sup> Thus, so long as services sold to a utility are priced at no more than fair market value, the Board’s regulations permit an affiliate to earn a profit on such sales.

In its investigation, Stier Anderson analyzed NUI Utilities’ purchases from NUIEB through the Co-op as well as NUIEB’s purchases to fulfill its Co-op related sales obligations to NUI Utilities. Stier Anderson asserted that certain language in NUI Utilities’ agency agreement with NUIEB precluded NUIEB from receiving any compensation for gas sold to NUI Utilities.<sup>6</sup> Accordingly, Stier Anderson analyzed the Co-op transactions in order to determine the profit on such sales. Stier Anderson concluded that NUIEB both profited and lost money on sales through the Co-op to NUI Utilities. The reason for these results is that NUIEB’s sales were speculative, frequently requiring it to purchase gas in the market after the Co-op auctions concluded. Although Stier Anderson concluded that all of the sales by NUIEB to NUI Utilities were “priced within the market,” Stier Anderson nonetheless concluded that NUIEB profited in the net amount<sup>7</sup> of \$268,357.06 as a result of NUIEB’s sales to NUI Utilities through the Co-op. NUI Utilities proposes to refund this amount through ETG’s BGSS clause in order to resolve this proceeding.

In contrast to Stier Anderson’s specific calculations, Liberty’s claim of damages related to Co-op activities in the amount of \$1,159,000 rests on the assumption that NUIEB made \$0.187 on each dekatherm sold to NUI Utilities. This conclusion has no foundation and is directly contradicted by Stier Anderson’s finding. Stier Anderson’s finding should be adopted by the Board in lieu of any finding by Liberty.

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<sup>5</sup> See *N.J.A.C.* 14:4-5.5(t)(2).

<sup>6</sup> NUI Utilities does not believe that the agreement applied to sales of gas by NUIEB to NUI Utilities through the Co-op. Nonetheless, NUI Utilities is willing to accept Stier Anderson’s interpretation of the agreement in order to resolve this proceeding.

<sup>7</sup> This amount is net of \$4,264.09 of benefits realized by NUIEB, which were captured in Stier Anderson’s analyses of comparable transactions involving ETG and NUIEB. Stier Anderson’s exhaustive analysis of comparable transactions involving ETG and NUIEB is discussed more fully below in response to Recommendation VI-3.



**Recommendation VI-3. Reimburse Customers Through Future BGSS Adjustments Of Excess Costs Of ETG Sales And Purchases Made Or Arranged By NUIEB.**

Reduced to their essentials, there are two issues raised in Liberty's audit that Liberty believes should persuade the Board to require NUI Utilities to make significant additional refunds. The first issue is whether an analysis of transactions involving NUI Utilities or NUIEB that are deemed to be comparable demonstrates that NUIEB engaged in a pattern of ensuring that NUIEB received better prices for sales and purchases on behalf of its own portfolio than it obtained on behalf of ETG. With respect to this issue, Stier Anderson has, at the request of the Audit Committee of the Board of Directors of NUI, conducted an analysis of approximately 42,000 transactions involving NUI Utilities and NUIEB for the sale and purchase of natural gas. These transactions date back to 1997. This analysis shows that with respect to 4,347 ETG transactions deemed to be comparable to NUIEB transactions (1) 78% of the time, ETG failed to get the best price of the day, (2) 77% of the time, ETG received less than the average price, and (3) 39% of the time, ETG received the worst price. Stier Anderson has determined that ETG's failure to get the best price resulted in damages of \$6.417 million over the 1997-2003 period.<sup>8</sup> Stier Anderson has further advised NUI that it has observed a pattern of sleeving, wherein, for example, ETG's gas was sold to an intermediary who in turn sold it to NUIEB, who would sell it to a third party and evidence that NUIEB switched deals between NUIEB and ETG to give NUIEB the better price. Stier Anderson has advised NUI that its damages calculation includes damages associated with transactions that reflect sleeving.

While Liberty apparently agrees that Stier Anderson's analysis captures some of the potential harm allegedly perpetrated by NUIEB on ETG, it nonetheless believes that far greater harm occurred, and it presents a series of assumptions which Liberty then analyses in order to support a claim that NUIEB did a very poor job of managing ETG's interstate pipeline capacity. Based on these assumptions and analyses, Liberty arrives at an "upper bound" estimate of total damages by NUIEB to ETG of approximately \$14.7 million. This damage amount is calculated by comparing the weighted average cost

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<sup>8</sup> This represents the largest amount of damages calculated by Stier Anderson.

of sales or purchases, as applicable, on behalf of ETG over each annual period from 1999-2003 to the weighted average cost of sales or purchases obtained by NUIEB on all volumes for the same annual periods. Liberty justifies what it terms this “one-for-all, all-for-one” approach by its claim that it comports with the way NUIEB ran its business during that period.<sup>9</sup> Liberty sums up its approach by stating that it “simply does not agree that failure to find direct means for quantifying harm . . . means that no consequence should attach.”<sup>10</sup> At bottom, Liberty’s analysis is based on complementary assertions that (1) NUIEB did a poor job with the transactions it arranged for ETG, and (2) NUIEB did a poor job by not pursuing transactions that might have benefited ETG.

As discussed more fully below, the various analyses relied upon by Liberty to support its assumption that NUIEB did a poor job for ETG simply do not withstand scrutiny once all the relevant facts are considered. Moreover, the damages calculation advanced by Liberty is an apples and oranges comparison that cannot be supported under the circumstances. As more fully discussed below, NUI Utilities submits that a review of all of the relevant information will support a finding by the Board that the maximum amount that NUIEB should be required to refund to NUI Utilities is \$6,417,464.83 as determined by Stier Anderson.

In advancing this position, NUI is cognizant of the fact that being required to refund approximately \$6.4 million to its customers is not an issue that should be swept under the rug or lightly dismissed. NUI is working hard to address the circumstances that led to the need to make these refunds. The arguments set forth below are intended to advance only NUI’s legitimate interests in ensuring that its shareholders are not unduly harmed by damage claims that cannot be supported or sustained, but which recognize based on the Stier Anderson report, that ETG’s customers are entitled to certain refunds.

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<sup>9</sup> Audit Report at VI-60.

<sup>10</sup> *Id.*

**Liberty's Analyses Of NUIEB's Overall Performance Are Based On  
Misleading, Erroneous Or Incomplete Data And Do Not Withstand  
Scrutiny**

Liberty asserts that the standard to apply in evaluating NUIEB's performance in managing ETG's upstream capacity is to consider how much of available secondary market revenue NUIEB produces.<sup>11</sup> However, having asked this question, Liberty proceeds to rely on misleading, erroneous or incomplete data to support a conclusion that NUIEB's performance justifies requiring ETG to refund approximately \$14.7 million, over \$8 million more than the \$6.4 million of refund liability calculated by Stier Anderson. ETG believes that once Liberty's errors and omissions are corrected, the only logical and reasonable conclusion that can be drawn is that ETG should not be required to refund to its BGSS customers more than the maximum level of damages determined by Stier Anderson.

One major mistake that Liberty makes in its various analyses is that it overstates the quantity of capacity available to NUIEB to make secondary market transactions on behalf of ETG during the 2000-2002 period. Liberty correctly recognizes that interstate pipeline capacity in excess of ETG's firm customers' demands is available to make non-firm, on-system sales, off-system sales and capacity release transactions.<sup>12</sup> However, Liberty goes on to make the claim that on-system non-firm sales are "relatively small" for ETG and the State's other gas-only LDCs.<sup>13</sup> Prior to NUI fiscal year 2003 - - the period

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<sup>11</sup> See Report at VI-33. At the outset of this discussion, NUI Utilities questions whether a generalized inquiry into the prudence of its conduct of secondary market transactions, with an apparent intent to apply the results of that inquiry retroactively, is appropriate at all. The Board long ago adopted an incentive regulatory framework for the conduct of secondary market transactions, under which the State's LDCs were encouraged to pursue capacity release and off-system sales transactions that benefited their on-system customers. The Board has never, to NUI Utilities' knowledge, conducted a prudence investigation into whether an LDC maximized its off-system activities or articulated a standard that an LDC would be required to meet in order to ensure that its margins from secondary transactions would be considered prudent. Under these circumstances, NUI Utilities submits that it is unreasonable to require the Company to now disprove in 2004 that its secondary market activities from 2000-2003 were imprudent. It is hard enough to prove a negative; it is an unreasonable burden to force a party to retroactively disprove an assumption of a negative. ETG's off-system results have been reviewed by the Board, its Staff and the Ratepayer Advocate in numerous Basic Gas Supply Service proceedings, and no party has previously asserted that NUI Utilities was doing a poor job in this area, or that its margin sharing formula should be revised.

<sup>12</sup> See Audit Report at VI-32.

<sup>13</sup> *Id.*

beginning October 1, 2002 -- this statement was simply not true for ETG.<sup>14</sup> ETG's on-system, non-firm sales for the period fiscal year 2000 through fiscal year 2003 are as follows:

<u>Year</u>	<u>Dth</u>
2000	11,003,181
2001	7,391,778
2002	7,530,112
2003	2,530,476 <sup>15</sup>

This level of on-system, non-firm sales, which can hardly be said to be "relatively small" during the 2000-2002 period, has dramatic implications for a significant number of the analyses presented by Liberty in support of its "NUIEB did a poor job in the secondary market" theory.

For example, on page VI-32 of the Audit Report, Liberty presents a table that compares ETG's off-system sales and capacity release transactions to ETG's estimated upstream reserve capacity, which is normally available to engage in such transactions. In presenting this information, Liberty obviously is attempting to demonstrate that NUIEB utilized a relatively low percentage of ETG's available capacity. However, Liberty does not include on-system, non-firm sales in its analyses, even though it acknowledges on the same page of the audit report that such sales would use available capacity. Had Liberty properly included on-system, non-firm sales, its table would appear as follows:

<u>Fiscal Year</u>	<u>Estimated Reserves (MDth)</u>	<u>On-System Non-Firm Sales (MDth)</u>	<u>Off-System Sales (MDth)</u>	<u>Capacity Release (MDth)</u>	<u>% Of Reserved Capacity Used</u>
2000	21.7	11	8.6	6.4	120
2001	27.5	7.4	15.3	3.0	93
2002	24.1	7.5	15.9	5.3	119
2003	26.7	2.5	10.4	3.9	63

Properly adjusted to include ETG's priority obligation to make on-system, non-firm sales,<sup>16</sup> the resulting table demonstrates that (1) NUIEB consistently utilized a quantity of capacity in excess of the reserve

<sup>14</sup> NUI Utilities assumes that Liberty's statement is true for New Jersey Natural Gas Company ("NJN") and South Jersey Gas Company ("SJG").

<sup>15</sup> On system, non-firm sales have dropped over the past few years because many of the customers who formerly purchased that service have converted to transportation service. Such conversions benefited ETG's firm customers by freeing up upstream capacity for secondary market transactions while allowing the Company to continue to generate on-system margins from transportation service rather than non-firm sales service.

<sup>16</sup> On-system, non-firm customers pay service and, in some cases, demand charges to ETG. As a consequence, these customers are given a priority over off-system sales.

quantity available for such transactions during the two warmer-than-normal winters, 2000 and 2002, not 65% and 85% of that capacity as claimed by Liberty, and (2) NUIEB made less use of the reserve capacity in 2003 - - the year in which, according to Liberty, NUIEB supposedly did a much better job for ETG because activity for its own book was reduced as a result of NUI's fiscal constraints.<sup>17</sup> The simple fact of the matter is that NUIEB used more capacity in the warmer-than-normal winters 2000 and 2002 to generate comparatively less margin than it did in the colder-than-normal winters because there was less price volatility in the warmer-than-normal winters even though there was more capacity available. Moreover, the relatively low use of capacity in 2003 is attributable to the fact that the 2002-2003 winter period was the third coldest winter in 20 years.<sup>18</sup> As a consequence, capacity that could be used to make off-system sales under normal conditions was needed to serve the needs of firm customers. Nonetheless, the gas market conditions experienced in the 2002-2003 winter permitted NUIEB to generate higher off-system margins using less capacity.<sup>19</sup>

The proper inclusion of on-system, non-firm sales also refutes what Liberty appears to be trying to show by means of a comparison between secondary market activities for ETG, NJN and SJG for fiscal year 2002.<sup>20</sup> The audit report overstates ETG's design weather reserve capacity by listing it as 29.0 Bcf rather than 24.1 Bcf as set forth in the immediately preceding table. In addition, the inclusion of ETG's on-system, non-firm sales in the analysis produces the following results:

	<b>ETG</b>	<b>NJN</b>	<b>SJG</b>
Design Weather Reserve	24.1	43.3	53.6
OSS, Capacity Release And Non-Firm Sales	28.7	96.5	68.0
OSS And Capacity Release/Design Reserve	1.19	2.23	1.27

Properly adjusted, and contrary to Liberty's apparent claim, ETG and SJG's percentage utilization of their upstream capacity reserves are practically identical. Moreover, the fact that NJN's figures show a greater

<sup>17</sup> Audit Report at VI-61-62.

<sup>18</sup> The only colder winters during that 20-year period were the winters of 1993-1994 and 1995-1996.

<sup>19</sup> In the 2002-2003 winter period, prices rose in March and April and NUIEB was thus able to realize extraordinary margins by selling storage gas available at the end of the heating season at a considerable profit.

<sup>20</sup> See Audit Report at VI-32.

volume of sales does not mean that NJN is more aggressive or is deriving better results than the other LDCs. The fact that one entity is generating more transactions could mean, for example, that NJN is segmenting<sup>21</sup> its capacity<sup>22</sup> to a greater extent, thus creating more transactions at a lower margin per transaction.<sup>23</sup> Without more information, no meaningful comparison can be drawn with respect to the activity of the three LDCs, but this also means that the BPU should not rely on incomplete and meaningless comparisons to support a conclusion that NUIEB was doing a poorer job than NJN and SJG.

Indeed, Liberty's claim that ETG's off-system credits are comparatively low as a percentage of fixed supply costs as compared to NJN and SJG and, in total magnitude, comparatively even lower<sup>24</sup> proves nothing about ETG's performance in the secondary market. LDCs purchase firm interstate pipeline transportation, storage and peaking capacity in order to serve the requirements of their on-system, firm sales customers. If an LDC could perfectly match its capacity purchases to its firm requirements, it would make no off-system transactions and its unitized fixed cost of purchasing gas would be at the optimal level. Since capacity purchases and firm demands cannot be perfectly matched, the BPU has given the State's LDCs an incentive to engage in on-system, non-firm sales, off-system sales and capacity release transactions in order to encourage the LDCs to minimize their fixed cost of purchasing gas. However, contrary to Liberty's suggestion, the ultimate goal of an appropriate least cost purchasing strategy is not to have the highest level of off-system margins or the highest level of such margins as a percentage of fixed supply costs, it is to have the lowest fixed cost of purchasing supply. ETG has the lowest fixed cost of purchasing supply in the State.

Liberty acknowledges that ETG has the lowest fixed cost of purchasing supply of the State's three LDCs, but dismisses this information for three stated reasons:

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<sup>21</sup> Segmenting is permitted by the Federal Energy Regulatory Commission. It allows a holder of firm capacity to divide its pipeline capacity into smaller pieces and sell the pieces separately.

<sup>22</sup> It could also mean that Liberty's numbers are inaccurate. For example, a review of New Jersey Natural Gas Company's Fiscal Year 2004 forecast as filed with the Board shows that it appears to have a design weather reserve capacity of at least 52 MDth, not 43.3 MDth as stated by Liberty.

<sup>23</sup> For example, one might sell gas under a Transco long haul Texas-New Jersey contract from Louisiana to North Carolina for \$0.05 margin, and then use the North Carolina to New Jersey capacity on the same day to make another sale at \$0.05 margin. Alternatively, a party might use the same capacity to make a single sale from Louisiana to New Jersey at a \$0.10 margin.

<sup>24</sup> Audit Report at VI-33.

- (1) ETG has a higher percentage of peaking capacity;
  - (2) ETG has a higher percentage of industrial customers and therefore a higher load factor;
- and
- (3) ETG has a different vintage of contracts for pipeline capacity.<sup>25</sup>

While ETG does have a higher percentage of peaking contracts, this is due to the fact that ETG has customers who generate their largest requirements on a limited number of peak days - - the coldest days of the winter. In serving these loads, ETG could choose to purchase 365-day pipeline transportation contracts, seasonal storage contracts or peaking contracts that are available only a few days per year. By selecting peaking contracts, ETG achieves the most efficient relationship possible between firm customers' demands and the Company's fixed cost of purchasing gas. At the same time, by purchasing peaking capacity, ETG virtually eliminates the possibility that it can generate off-system margins using the peaking capacity. ETG should not be criticized for purchasing peaking contracts that minimize its fixed cost of purchasing gas merely because such contracts also minimize its off-system margin generation prospects. Such criticism would amount to a case of the tail wagging the dog.

Another factor, ignored by Liberty, but relevant to the issue of whether NUIEB was maximizing margins from secondary market transactions, is that ETG's upstream transportation capacity portfolio contains approximately 25,000 Dth per day of short-haul capacity from Leidy, Pennsylvania to ETG's New Jersey city gates. Like the Company's peaking capacity, short-haul transportation minimizes ETG's fixed cost of purchasing gas, but also minimizes its opportunities to generate revenues in the secondary markets.

With respect to Liberty's claim that ETG's percentage of industrial customers creates higher load factor use of ETG's upstream pipeline capacity,<sup>26</sup> its statement is simply wrong. Virtually all of ETG's firm industrial sales customers converted to transportation service in the 1980s. By doing so, they no

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<sup>25</sup>

*Id.*

<sup>26</sup>

Audit Report at VI-33.

longer utilize ETG's upstream pipeline capacity. ETG believes that the system load factor of its firm sales customers is comparable to the load factors of customers served by NJN and SJG.

Finally, with respect to Liberty's claim about the vintage of pipeline contracts, ETG can only note that it has participated in numerous pipeline expansions since 1985 and purchases a number of incrementally priced pipeline services. ETG has no basis to believe that the State's other LDCs have purchased significantly larger quantities of incrementally priced capacity.

In sum, contrary to Liberty's claim, there is no reason why the Board should look at the total magnitude of ETG's off-system margins over the past four years, or the magnitude of those margins as a percentage of total fixed supply costs as compared to similar statistics for the State's other LDCs, and conclude that ETG or NUIEB has done a poor job. Looking at ETG's fixed cost of purchasing gas and mix of capacity assets should convince the Board that the Company has done a very reasonable job of planning for the needs of its firm customers.

Another misleading and erroneous analysis that Liberty relies upon to support its "NUIEB did a poor job theory" is the claim that NUIEB did a much better job for ETG in fiscal year 2003, after, according to Liberty, NUIEB found its own business curtailed due to fiscal constraints. First, contrary to Liberty's claim, data from 2003 does not show that ETG's margins grew as fiscal year 2003 progressed.<sup>27</sup> Rather, the Table VI.37 shows that ETG's margins over a two month period, March and April 2003, were extraordinary, \$956,000 in March and \$959,000 in April. These margins were attributable to an increased level of prices in those two months and the availability of low-priced storage gas for off-system sales at the end of the heating season. If data from these two months are eliminated, and the remaining 10 months of fiscal year 2003 are annualized, ETG's margins for off-system transactions total \$2,777,000; a level consistent with NUIEB's results in the 2000-2002 period.

Second, contrary to Liberty's claim, the extraordinary margins derived in March and April 2003 were earned prior to the significant downgrades that curtailed NUIEB's business. The downgrades that significantly affected NUIEB's business were those that put NUI below investment grade. These

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<sup>27</sup> Audit Report at VI-61-62.



downgrades occurred in May of 2003. NUIEB continued to do significant business in March and April of 2003, but was nonetheless able to generate unprecedented off-system margins for ETG.

Third, when prior period data are considered, it is not the case that ETG's margins grew as NUIEB's own sales fell. While NUIEB's sales certainly fell after the May downgrades, ETG's off-system transaction margins also actually declined in the last four months of 2003 as compared to fiscal year 2002. In fiscal 2002, ETG generated \$898,000 of margins for the months of June through September as compared to \$740,000 for the same period of 2003.

Finally, as discussed previously, in order to properly compare NUIEB's efforts in fiscal year 2003 to its efforts in the 2000-2002 period, it is necessary to include the impact of on-system, non-firm sales, which (1) affected the amount of capacity available for off-system transactions, and (2) declined in fiscal year 2003. While ETG acknowledges that a comparison of margins from these activities to margins from off-system sales is not completely apples to apples because the margins from on-system activities were set by tariff rather than market conditions,<sup>28</sup> the comparison nonetheless presents a more complete analysis of NUIEB's performance in managing the use of ETG's upstream capacity than Liberty's analysis, which ignores these on-system transactions. The comparison is as follows:

	<b>Total Margins/Credits From On-System, Non Firm And Off-System Transactions</b>
2003	\$4,412,553
2002	\$4,777,110
2001	\$3,621,523
2000	6,723,444

The simple fact of the matter is that other than the fact that NUIEB was able to take advantage of some unusual circumstances in 2003, there is very little difference between NUIEB's performance in 2003 and its performance in prior years.<sup>29</sup> Moreover, there is no reason why NUIEB's performance for

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<sup>28</sup> ETG likely could have generated more margins from on-system, non-firm sales if it has not been constrained by the pricing provisions of its tariffs.

<sup>29</sup> Moreover, as discussed above, none of the bids received by NUI Utilities to manage its gas supply during the 2004-2005 period reflect a value for ETG's portfolio that appears to be greater than the value of NUIEB's historical performance.

ETG in 2003 should be used to justify requiring ETG to make refunds for prior periods, as suggested by Liberty.<sup>30</sup>

As the foregoing discussion demonstrates, Liberty has presented no objective analysis of NUIEB's performance on behalf of ETG that substantiates a view that (1) NUIEB failed to maximize the use of ETG's capacity, or (2) in situations other than those involving the comparable transactions identified by Stier Anderson, NUIEB failed to maximize the value of upstream capacity for ETG. In this regard, Liberty's assertion that NUIEB personnel paid less attention to ETG's secondary market transactions<sup>31</sup> appears to be based on the assertions of a single NUIEB trader.<sup>32</sup> ETG submits that isolated statements by one or two NUIEB personnel that are not supported by underlying data or analysis are insufficient to support an incremental disallowance of more than \$9 million.

**Liberty's "One-For-All, All-For-One" Damages Calculation Relies  
On A Comparison Of Activities That Cannot Be Shown To Be  
Comparable**

As discussed above, Liberty's proposed damages calculations compares the weighted average cost of sales or purchases, as applicable, on behalf of ETG over an annual period, to the weighted average cost of sales or purchases obtained by NUIEB on all volumes for the same annual periods. This calculation is performed separately for three different regions; the production area, the market area and the production/market area. There are several glaring flaws in this approach, and any of these flaws should cause the Board to reject Liberty's analysis as not reflecting a reasonable means of determining ETG's refund liability in this case.

First, the use of a weighted average calculation can produce skewed results even in situations where no harm can be shown. This is best illustrated by the following hypothetical in which we assume that NUIEB and ETG make the following sales on the same dates, at the same delivery points, with the same flow dates and service priority:

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<sup>30</sup> Audit Report at VI-62.

<sup>31</sup> Audit Report at VI-59.

<sup>32</sup> At Page VI-22 of the Audit Report, Liberty states: "there have been admissions by at least one trader." Similar language appears at pages VI-58-59 and VI-68. It is NUI Utilities' understanding that these statements are all attributable to a single NUIEB trader.

		<b>Date</b>	<b>Volume</b>	<b>Price</b>	<b>Difference</b>
1.	ETG	1/1	10,000	\$10.00	
	NUIEB	1/1	100,000	\$10.00	0.00
2.	ETG	5/1	100,000	\$3.00	
	NUIEB	5/1	10,000	\$3.00	0.00

In this example, even though there was no difference in price and no damage to ETG, the weighted average calculation employed by Liberty would produce a difference of \$2.87 (a weighted average price of \$6.50 for the total of NUIEB and ETG's transactions compared to a weighted average price of \$3.63 for just ETG's transactions) and a damage calculation of more than \$300,000. This results solely from the differences in the quantities sold at different times of the year. Such bizarre computational results obviously must be avoided.

While it is conceivable that the use of the weighted average method could be justified in some circumstances in spite of the possibility that it can produce skewed results if it could be shown that the off-system activities of NUIEB and ETG were typically comparable, the evidence indicates that this is not the case. As discussed previously, Stier Anderson conducted an unbiased analysis of all 42,000 transactions completed by NUIEB over an eight-year period. In performing this analysis, Stier Anderson brought in experts from Charles River Associates and Exeter Consultants; two firms with extensive experience in the natural gas industry.<sup>33</sup> Stier Anderson concluded that of the 42,000 transactions analyzed, 4,347 ETG transactions were comparable to 5,667 NUIEB transactions. The remainder of the transactions were not comparable, and there is no reason why the differences in price between transactions that are not comparable should play a role in determining the refunds that ETG ultimately should make to its customers.

The lack of logic in Liberty's damages analysis is perhaps best demonstrated by examining the results of the analysis itself. In Liberty's analysis, \$9.93 million of the damages that Liberty alleges to have occurred as a result of NUIEB's sales at prices in excess of those obtained for ETG, and \$4.54

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<sup>33</sup> Both of these firms have been employed either by the Board or the Ratepayer Advocate.

million of the damages allegedly associated with purchases by NUIEB for its own account at prices that were lower than those obtained for ETG, occurred during 2001.<sup>34</sup> At the same time, ETG's off-system sales in 2001 totaled 15.3 Bcf. The implication of Liberty's analysis is that in 2001, ETG should have obtained approximately \$0.65 more for each dekatherm of gas sold off-system.<sup>35</sup> Moreover, if it is assumed that ETG had to make incremental purchases of the 15.3 Bcf sold off-system,<sup>36</sup> then the further implication of Liberty's analysis is that ETG should have purchased each dekatherm sold for approximately \$0.30 less. Thus, according to Liberty, in total ETG should have generated approximately \$0.95 of incremental margins for each dekatherm sold (\$0.65 plus \$0.30). These results are simply not reasonable when one considers that the observed variability in daily gas prices reported at the places where gas is bought and sold is typically no more than a few cents. Indeed, if the Board were to review the comparable transaction data compiled by both Liberty and Stier Anderson, it would see that the price spreads on comparable transactions are typically no more than a few cents per dekatherm. Yet Liberty's damages calculation presumes this \$0.95 per dekatherm could have been earned on every dekatherm sold.

While Liberty's response to this criticism would be that its analysis does not place any value on transactions that NUIEB should have, but did not enter into in 2001,<sup>37</sup> there is simply no evidence that such foregone transactions exist. As discussed above, in 2001, a colder-than-normal winter in which ETG would have used a larger than average percentage of its available upstream capacity to serve firm customers, ETG sold 7.4 Bcf of on-system, non-firm sales gas, 15.3 Bcf of off-system sales gas and released 3 Bcf of capacity. These transactions utilized 93% of ETG's available reserve capacity and generated \$4.286 million of margins. There is no evidence that NUIEB or any other capacity manager could have exceeded these results without potentially compromising ETG's ability to serve its firm customers. Thus, there is no basis for Liberty's contention that NUIEB left ETG capacity idle.

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<sup>34</sup> Audit Report at VI-60. On the purchase side, the damages in 2001 exceed the total purchase damages calculated by Liberty, which total \$3.9 million for the five-year period. In other words, on average, on a net basis, NUIEB obtained lower prices for ETG than it did for all of its purchases in four of the five years considered.

<sup>35</sup> This figure is derived by dividing \$9.93 million by 15.3 Bcf.

<sup>36</sup> Typically, some portion of this gas would be withdrawn from storage rather than purchased incrementally.

<sup>37</sup> See Audit Report at VI-60.

Another flaw in Liberty's analysis, which particularly affects its purchase analysis, is that in three of the five years considered, and in seven of the fifteen measurements taken as part of the analysis, NUIEB's results for ETG were better than its results for NUIEB as a whole. Thus, assuming that Liberty's analytical technique is not flawed, the result that it appears to show, at least for gas purchases, is that there was no pattern of favoritism. In the absence of any pattern, Liberty's proposed disallowance of \$3.93 million cannot be justified on any basis.

If the Board wishes to test Liberty's claim that NUIEB did a poor job of managing ETG's upstream capacity, then the way to conduct that test is to compare the prices paid by NUIEB for ETG's gas and the prices obtained by NUIEB for quantities sold on behalf of ETG to the published market indices at the points where the gas was purchased or sold. ETG is confident that its volumes were purchased and sold at prices consistent with market conditions, and to the extent that this is true, there is no reason why the Board should disallow costs in the amounts proposed by Liberty.

In addition, as Liberty notes in its report,<sup>38</sup> in the interest of resolving this matter, NUI personnel prepared an analysis of the potential refund liability arising from NUIEB's conduct of ETG's secondary market activities. NUI first determined the increased rate that, on average, ETG would have had to have obtained on comparable transactions in order to conclude that NUIEB and ETG were treated equally on such transactions. NUI's analyses then applied this rate difference to the total volumes purchased and sold by ETG in order to calculate a total refund liability of \$6.5 million before margin sharing. Liberty revised NUI's analysis to include a broader range of comparable transactions, and, in so doing, increased the \$6.5 million total to \$6.7 million before margin sharing. Other than this change, Liberty's report does not take issue with NUI's analysis. If ETG were given credit for its 15% margin sharing amount - - an adjustment to which it would be difficult to object - - the resulting refund liability calculation would be between \$5.525 million and \$5.7 million.

NUI submits that the depth and breadth of the Stier Anderson analysis, as well as the absence of any meaningful evidence that NUIEB's conduct of ETG's secondary market activities created any refund

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<sup>38</sup> Audit Report at VI-62 through 64.

liability other than that associated with comparable transactions, obviates the need for the Board to consider any analysis other than Stier Anderson's in determining refunds in this proceeding. Nonetheless, to the extent the Board wishes to check the reasonableness of Stier Anderson's results, NUI's analysis provides such a check. In contrast, Liberty's calculation is clearly arbitrary and should not be accepted.

### **Liberty's Erroneous Characterizations Of Events Led To Its Illogical Damages Recommendation**

In Chapter Six of its Audit Report, Liberty presents a number of summaries of what should be relatively straightforward facts. However, Liberty mischaracterizes many of these facts and portrays them in a manner that results in findings of wrongdoing even where none existed.

For example, on Page VI-12 of the Audit Report, Liberty criticizes NUIEB's management of ETG's Rate Schedule WSS storage agreement with Transco. Liberty references the Board's July 7, 1999 Order in Docket No. GR98080532 *et al.* in which the Board approved a stipulation concerning the WSS service. The Board-approved stipulation stated in relevant part:

The Company . . . shall remove all costs associated with the WSS storage service purchased from Transcontinental Gas Pipe Line Corporation ("Transco") from the LGAC from and after June 1, 1999. On a prospective basis, the Company shall bear all costs and retain all revenues derived from its operation of WSS . . . .

This stipulation provision is straightforward. The Board's approval of it was unambiguous, and consistent with the stipulation, ETG has not sought recovery of any costs associated with WSS since June 1, 1999. While ETG transferred its control of WSS to NUIEB in an attempt to shield the utility from potential liability arising from the speculative WSS transactions in which NUIEB was engaged, this result was entirely consistent with the reason why the costs of the WSS service were removed from ETG's Levelized Gas Adjustment Clause. The Board's order clearly recognized that NUI's shareholders would bear the costs and receive the benefits of the use of WSS service.

Liberty however is not content with the BPU's 1999 Decision or the Company's actions in compliance with that Order. Instead, Liberty asserts that ETG should have "turned back" the storage to

Transco, or “put storage rights out for bid in secondary markets.”<sup>39</sup> According to Liberty, this latter option “would allow customer recovery of disposition benefits.” Moreover, Liberty criticizes ETG because the “positive value” of WSS was not captured by customers.<sup>40</sup>

Whatever Liberty thinks of the WSS transaction or the BPU Decision in 1999, the simple fact is that the Board authorized ETG to bear the costs and reap any benefits of WSS that they could reap. Customers did not pay the costs of WSS and they did not receive the benefits. Liberty’s willingness to go back and criticize a nearly five-year old BPU Decision, supported by the Board Staff and the Ratepayer Advocate, amounts to a finding of wrongdoing where none existed. Based on such erroneous characterizations of events, Liberty, despite the absence of any meaningful evidence, recommends that ETG should be required to refund more than \$8 million of incremental, wholly speculative “damages” to its customers.<sup>41</sup>

In contrast to the negativity with which Liberty has approached issues involving NUIEB, Stier Anderson has conducted a full investigation of ETG’s relationship with NUIEB. Stier Anderson has utilized experts often used by the BPU and the Ratepayer Advocate who are fully conversant with the markets in which gas is bought and sold. Stier Anderson has in fact concluded that NUIEB caused damage to NUI Utilities. However, Stier Anderson has not relied on innuendo or incomplete information in order to invent non-existent damages. In considering the level of refunds that NUI Utilities may owe to its customers in this proceeding, NUI Utilities requests the Board to recognize that Stier Anderson is not beholden to NUI Corporation or NUIEB, and that its calculation of harm to ETG is concrete and well supported. It is Stier Anderson’s results that should be adopted by the Board.

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<sup>39</sup> Audit Report at VI-12.

<sup>40</sup> Liberty’s position on this issue not only reveals a predisposition, it is completely wrong as a matter of economics. The most that ETG’s customers could have received from a release of WSS in the secondary market was the maximum rate paid by ETG. Customers already received benefit as a result of the fact that ETG agreed to bear the full costs of the service.

<sup>41</sup> Liberty’s discussion of other issues, such as those raised by NUIEB’s participation in the Co-op is fraught with similar errors. In the interest of brevity, NUI Utilities will not attempt to identify every statement that is either erroneous or unreasonable.

**Recommendation VI-4. Require ETG To Refund To Customers The Amount By Which ETG's Allocations Of NUI Costs Were Inflated Due To The Failure To Make Allocation To Virginia Gas.**

There are several reasons why ETG should not be required to refund \$287,292 to its customers in order to compensate them for allocation of costs that could have been assigned to Virginia Gas. Nonetheless, in order to resolve this proceeding quickly, NUI is willing to accept this recommendation as part of an overall settlement of this matter. On the other hand, if settlement is not possible, then NUI requests that this issue be included in those set for hearing.

**Comments Regarding Chapter Four: Finance**

**Recommendation IV-1. Require A Rate Refund To Reflect A Reduction In Equity Levels From December 2002-November 2003, In Order To Account Properly For The Receivables Balance Due To NUI Utilities From NUI.**

In its December 16, 2003 comments concerning Liberty's summary report, NUI explained in detail why it disagreed with this recommendation. NUI will not repeat all of these arguments here. Nonetheless, a few points bear further emphasis.

First, Liberty's reasoning that the inter-company receivable was not a "good asset" is flawed. The receivable has been repaid in full, certainly the prime test for determining whether a receivable is a good asset. Moreover, as explained in more detail in NUI's December comments, had the receivable been reflected on ETG's books, it would not have affected ETG's capital structure for ratemaking purposes in any event. Thus, there is no evidence that ETG did not have access to the equity capital included in its rate case. There is accordingly no basis to order a refund to customers based on the existence of a now-satisfied receivable. Liberty also ignores the basic ratemaking concept that rates are set on rate base, not capitalization, and that therefore capitalization should generally be similar to rate base, as investors and utilities know that their investment goes into rate base. Liberty nowhere explains why it would be appropriate to adjust capitalization in a situation where there is no corresponding adjustment to rate base.

If Liberty is right that an intercompany receivables balance should reduce ETG's equity capital, then presumably Liberty would also have to agree that an intercompany payables balance should have



increased ETG's equity capital.<sup>42</sup> But this idea illustrates the faulty reasoning that is the basis of Liberty's recommendation. The capital structure utilized in ETG's rate case reflected an equity component of the stand-alone utility without any adjustments for gains or losses from unregulated operations. There is no reason why ETG's capitalization should be adjusted for gains or losses from unregulated operations for periods beyond the conclusion of the rate case.<sup>43</sup>

**Recommendation IV-2. The NJBPU Should Require NUI Utilities, ETG And Their Successors And Assigns To Implement And Maintain Within 90 Days Ring-Fencing Provisions That Seek To Re-Establish And Maintain An Investment-Grade Credit Rating Based Upon Stand-Along Credit Statistics And Effective Credit Insulation.**

Liberty's recommendation that all nine ring-fencing provisions be applied to NUI's "successors and assigns" is unreasonable. Assuming that a buyer is found, NUI and that buyer are required by law to seek BPU approval of that transaction pursuant to applicable statutory requirements, and the BPU will be able to determine at that time what ring-fencing provisions are appropriate for that proposed buyer.

NUI's responses to the 9 specific ring-fencing provisions to be effective until a sale closes are as follows.

**1. Equity Maintenance.** NUI suggests that if the Board wishes to adopt an equity maintenance standard, it should be tied to that appropriate for investment grade LDC gas utilities, and be calculated on an annual average basis, with an allowance for reasonable fluctuations due to weather and other similar factors. In addition, for an LDC which is subject to significant seasonal capital requirements, such as ETG, any total capital requirement does not make sense and should be replaced with a requirement that short term debt be paid off at least every twelve months.

Liberty's suggestion of notice to the Board of certain transfers is unobjectionable, provided it is understood that the limitation is not cumulative beyond a single calendar quarter. NUI believes that a restriction tied to total shareholders' equity might make more sense.

**2. Cash Management.** NUI has already implemented this recommendation.

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<sup>42</sup> Until late 2002, NUI Utilities' intercompany was a payable.

<sup>43</sup> As the Board is well aware, the Board does not have the authority to engage in retroactive ratemaking, regardless of whether such ratemaking benefits the utility or the ratepayers. *See Petition Of Elizabethtown Water Co.*, 107 N.J. 440, 450, 453-54, 459 (1987).

3. ***Accounting and Financial Statements.*** NUI has already agreed to many of these measures. The Company agrees to provide financial statements for ETG and NUI Utilities on a regular periodic basis to the BPU. It currently provides monthly statements for ETG as well as the annual report. There is currently no requirement for annual statements to be audited and the Company does not believe that an audit requirement should be applicable to NUI Utilities and ETG, if it does not apply to other utilities in the state.

NUI disagrees with the recommendation to “push down” all of NUI Utilities’ assets and liabilities to ETG and other divisions. The major assets and liabilities of NUI Utilities relate to the borrowing of NUI Utilities on behalf of its three utility operating divisions. To push these down to ETG and the other utility divisions would effectively result in a restatement of the inter-company balances with NUI Utilities as notes payable to banks, which the company had previously done and which Liberty has asserted to be a violation of the FERC Uniform System of Accounts (see Chapter 5, conclusion V-6). With regard to other assets and liabilities, such as cash, prepayments and accounts payable, the assignment of these balances to the utility divisions would be arbitrary, burdensome and of doubtful benefit. If NUI is issuing reports to the BPU for both ETG and NUI Utilities, those statements should provide the BPU with all the information the BPU needs on both a divisional and total company basis.

4. ***Inter-company loans.*** NUI has already agreed to these measures.

5. ***Affiliate Transactions.*** NUI has already agreed to these measures, with the understanding that these measures do not apply to services provided by a third party to all NUI companies, e.g., group insurance and other benefit programs, pension and 401(k), and the like, and that the universe of agreements requiring approval is that established by statute.

6. ***Asset Sales and Collateral.*** It must be remembered that ETG is not separately incorporated, but rather is a division of NUI Utilities. In the event NUI Utilities were to incur secured debt, its assets would be subject to a lien regardless of whether those assets were located in New Jersey, Florida, Maryland or elsewhere. However, no pledge of assets could occur without BPU approval, and

asset sales are also subject to BPU supervision, so Liberty's recommendations may be moot, as the BPU controls the Company's secure debt.

7. ***Corporate Structure and Bankruptcy Protection.*** NUI has already staffed the management of NUI Utilities with different personnel than those holding management positions at NUI and created a separate Board of Directors for NUI Utilities. To the extent Liberty's proposal goes beyond this, for example, by requiring the NUI Utilities' Directors to disregard their fiduciary duty to NUI Utilities' shareholder (NUI), Liberty's proposal is inconsistent with fiduciary duties established by New Jersey statute and case law. Additionally, NUI is not aware of any corporate structure that could create "bankruptcy proof" company.

8. ***Corporate Costs and Allocation Factors.*** NUI is willing to discuss revised allocation procedures on a prospective basis. To the extent Liberty's proposal would prevent NUI Utilities from paying its fair share of corporate overhead costs, NUI would not agree.

9. ***Financing Separation.*** NUI Utilities has no plans for new debt or preferred stock financings. However, to the extent Liberty's proposal would prevent the NUI Utilities' Board of Directors from exercising its reasonable business judgment in the future, NUI obviously could not agree.

**Recommendation IV-3. Reduce Future ETG BGSS Recovery By \$3,157,333 On Gas Cost Over/Under Recoveries To Reflect Those 2001, 2002 And 2003 Deferred-Payment Charges That Were Recovered From Customers.**

NUI Utilities does not dispute Liberty's conclusion that ETG incurred and included in its recoverable BGSS costs \$416,427 in 2002 and \$486,202 in 2003, which represented amounts associated with its suppliers' agreements to permit ETG to defer payments for gas purchased for injection into storage. As part of the resolution of this matter, NUI Utilities proposes to credit its BGSS clause with these amounts.

However, NUI Utilities strongly disagrees with Liberty's finding that ETG passed through its BGSS clause \$2,254,704 associated with a deferred payment arrangement that it entered into with Enron in 2001. The simple fact of the matter is that after all of the relevant transactions are netted out, ETG did

not seek to recoup these above-market costs from its customers. Therefore, there is no basis for the BPU to require ETG to refund this amount.

NUIEB negotiated a contract with Enron that required ETG to pay \$5.8169 per Dth for 8,560,000 Dth of gas purchased during the 2001 summer storage injection period. At the same time, NUIEB arranged a swap agreement with Enron that permitted ETG to realize significant benefits if the price of gas fell below the rate agreed to in the swap arrangement.<sup>44</sup> NUIEB entered into this agreement because it believed that the price of gas would decline during the 2001 summer period. This assumption proved correct, as ETG ultimately realized \$15.96 million of savings from the swap transaction. NUIEB also utilized an additional \$1.5 million derived from the swap transaction to offset certain losses incurred by ETG on off-system sales. As a result, ETG ultimately reflected in its BGSS clause a price of gas injected into storage of \$3.80 per Dth, a price considerably below the market range for prices that could have been obtained in April 2001 for the 2001 summer injection period.<sup>45</sup> This analysis of the Enron transaction has been confirmed by Stier Anderson. ETG never sought to recover any of the actual dollars associated with payments to Enron of above market costs under the deferred payment arrangement. Rather, ETG netted the payments under the swap against the costs incurred from Enron and sought recovery of the difference through its BGSS clause.

Under *N.J.S.A.* 48:3-58(r), gas supply procured for basic gas supply service by a gas public utility must be purchased at prices consistent with market conditions. Under the same statutory provision, the BPU is required to assess basic gas supply service charges that reflect the cost of providing such service, including the cost of gas commodity and capacity purchased at prices consistent with market conditions. In this case, ETG can easily establish that the prices it ultimately obtained for storage injection volumes in 2001, and the costs that it included for recovery through its BGSS clause for such volumes, were consistent with market conditions. While it may be true that ETG took a risk in executing an agreement

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<sup>44</sup> At the same time, if the price of gas had risen, ETG would have been liable for the difference between the swap price and the market price. There is little doubt that if ETG had lost money on the swap, Liberty would contend that any increased costs should not be passed through to ETG's customers.

<sup>45</sup> Those prices ranged between \$5.10 and \$5.40 during March of 2001.

with Enron in April 2001 that could have required ETG to incur an above market price for gas, ETG's action was not unlawful and ultimately caused no harm to its customers. Under these circumstances, there is no basis for the BPU to disallow costs that NUI Utilities ultimately did not seek to recover. Quite simply, there was no harm to customers.

Liberty's analysis of this transaction is apparently founded on the assumption that the mere fact that ETG entered into an above-market purchasing arrangement with Enron is sufficient to justify disallowing costs, regardless of whether ETG ever sought to recover any above-market costs from its customers or made other offsetting arrangements. Liberty's position is at odds with the well-established rule of restitution that holds that even where a tort or breach of contract has been committed, damages will only be assessed if they can be shown to have occurred.<sup>46</sup> To NUI Utilities' knowledge, the BPU has never disallowed costs associated with actions later determined to be imprudent that ultimately resulted in no harm, much less disallowed costs for which recovery had not been sought in the first place.

**Recommendation IV-4. Reduce Future ETG BGSS Recovery By \$3,097,961 For Enron Settlement Benefits That NUI Inappropriately Assigned To Non-Utility Affiliates.**

NUI Utilities opposes Liberty's recommendation that future BGSS costs be reduced by \$3,097,961 in order to provide ETG's customers with what Liberty claims to be "a fair share of benefits" negotiated by NUIEB under the settlement entered into between Enron, NUI and NUIEB in 2001. At the time of the settlement in November, 2001, NUI Utilities owed Enron \$49.7 million for gas that had previously been delivered. However, NUI Utilities did not have to begin paying that debt until December 2001, with a final payment due in April, 2002. At the same time, Enron owed NUIEB a total of \$4.9 million and Enron also owed NUI Utilities \$666,000. On November 30, 2001, NUI and Enron signed an agreement that resulted in NUI paying Enron \$42.9 million. This payment reflected NUI Utilities' debt to Enron for gas previously delivered, less the \$5.5 million owed by Enron to NUIEB and NUI Utilities, and a discount for the prepayment of NUI Utilities' debt, which totaled \$1,353,386.51.<sup>47</sup> This benefit was

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<sup>46</sup> See *Doe v. Chao*, U.S. Sup. Ct. Case 02-1370, 2004 LEXIS 1622 (February 24, 2004); *Coca-Cola Bottling Co. v. Coca-Cola*, 988 F.2d 386, 409 (3<sup>rd</sup> Cir. 1993).

<sup>47</sup> This amount has been confirmed by Stier Anderson.

retained by NUIEB. The financing to pay Enron the settlement amount was secured from two separate financial instruments – a \$20 million loan arranged by NUI and the balance from a discretionary line of credit held by NUI Utilities.

To the extent that the Board adopts Liberty’s Recommendation IV-3 and requires NUI Utilities to refund to its customers \$2,254,704 associated with the deferred payment arrangement with Enron in 2001,<sup>48</sup> then logically the \$1,353,386.51 discount obtained by NUI under the settlement should be used as an offset to this amount. Quite simply, this discount was provided because NUI Utilities paid its debt to Enron early, thus reducing the consideration paid for the deferred payment arrangement. There is no possible justification for requiring NUI Utilities to (i) absorb costs that Liberty characterizes as “interest” -- the consideration for the deferred payment arrangement, and then (ii) further return to customers the settlement payment that partially reduces these costs.

In addition, there is no reasonable justification for requiring NUI Utilities to refund to customers the offsetting benefits of the settlement realized by NUIEB and other NUI affiliates; *i.e.* the payment of \$4.8 million for amounts owed by Enron to these entities. Assuming that a significant portion of the \$1.3 million debt discount is credited to NUI Utilities’ customers, there is no reason why the Board should retroactively confiscate funds received from Enron by NUIEB in payment for obligations owed to those entities. This is because

- NUIEB negotiated the settlement with Enron and obviously would have negotiated an arrangement that would have provided an offset for amounts due to NUI and all of its affiliates as a condition of prepaying a portion of NUI Utilities’ obligations to Enron,
- NUI incurred \$312,066.67 of costs to finance the loans that partially enabled NUI Utilities to pay Enron under the settlement, and such costs were not passed on to NUI Utilities’ customers,

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<sup>48</sup> As discussed above, such a ruling would effectively require NUI Utilities to return to customers a cost that NUI Utilities never proposed to recover from its customers. Such a result is obviously unreasonable.

- NUI Utilities incurred an incremental cost of \$127,283 to finance the loan that it secured to fund the payment of the Enron settlement, and these incremental costs were not passed through to NUI Utilities' customers, and thus ultimately were borne by NUI, and
- The record shows, as discussed above, that NUIEB flowed through to ETG's customers the substantial benefits of NUIEB's swap transaction with Enron.

After thoroughly analyzing the Enron settlement and the transactions that led to that settlement, Stier Anderson concluded that a conservative resolution of the issues raised by the Enron settlement would be to require NUI Utilities to credit the \$1.3 million debt discount to its customers.<sup>49</sup> NUI Utilities submits that requiring a refund of the \$1,353,386 debt discount to ETG's customers is far more reasonable than Liberty's proposals to require Elizabethtown to refund \$2,254,704 of costs incurred under the Enron supply agreement, \$669,091 of the debt discount obtained through settlement and \$2,478,870 of the payment of the receivable to NUIEB. In addition, the end result of requiring NUI Utilities to refund the \$1,353,386 debt discount to its customers would be that NUI Utilities will have charged its customers less than \$3.70 per Dth to fill storage in 2001, even though all the market evidence indicates that NUI Utilities would have been fully justified in executing a 2001 storage refill agreement at an average price of \$5.10-\$5.40 per Dth. Clearly, this is a reasonable end result.

**Recommendation IV-5. Insofar As Necessary To Produce An Equity Level Of At Least 52 Percent At ETG, Require That NUI Pay Interest Premium Charges Of \$4,001,060 To ETG To Compensate The Utility For Lending Its Funds To Corp. And Its Non-Creditworthy Non-Utility Affiliates.**

Although this is purely an internal adjustment between NUI and ETG, NUI objects to this proposal because of its inappropriate ratemaking implications and because it could unnecessarily and unreasonably hamstring NUI's operations. NUI would not object to a requirement that NUI Utilities

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<sup>49</sup> Stier Anderson further opined that a more reasonable resolution of this matter would be to require NUI to credit between \$844,577 and \$1,168,602 to customers. Stier Anderson's calculation of the amounts to be returned to NUI Utilities' customers was intended to give full recognition to the facts that:

(1) NUI paid a \$250,000 origination fee to secure the loan used to fund NUI's share of the Enron settlement, as well as \$62,087 in interest. These costs were not assessed to NUI Utilities, but were offset by \$127,283 of interest that were passed onto NUI Utilities, but not its customers; and

(2) NUI financed 47% of the cost of the Enron settlement and NUI Utilities financed 53% of the costs. 53% of the \$1,353,386 is \$717,294. When this amount is added to the interest charged to NUI Utilities by NUI, the total amount due to ETG's customers is \$844,577.

maintain an investment grade capital structure for a gas LDC to be determined on an annual average basis at the end of the year.

### **Comments Regarding Chapter Three: General Affiliate Issues**

#### **Recommendation III-1. Confirm That Continued Overuse Of General Allocators And The Failure To Calculate Proper Overhead Rates Are Not Acceptable Following The Sale Of NUI.**

As discussed in its December comments, NUI's cost allocation methodology has been on file with the BPU for nearly ten years. NUI has adhered to this methodology throughout this period. Indeed, it was obligated to do so, because the BPU's holding company order specifically directed NUI to continue its cost allocations "using current methodologies" unless and until the BPU required otherwise.<sup>50</sup>

NUI is aware that there are other appropriate ways to allocate costs. ETG is willing to meet with Staff and other interested appropriate parties to discuss this issue further in an attempt to resolve this issue. Failing that, at some point, the BPU in its reasonable discretion may decide to resolve this issue, prospectively, based on a full and complete record. But it is unfair to criticize NUI for continuing to use the method that it proposed in 1994 and that it was specifically directed in 2001 to continue to use.

#### **Recommendation III-2. Require NUI To Return To Customers Excess Real Estate Costs For The First Year That New Base Rates Were In Effect.**

NUI disagrees with this recommendation, but in the interest of resolving this issue, NUI is willing to make the proposed refund as part of an overall settlement. On the other hand, if the settlement is not possible then NUI requests that this issue be included with those set for hearing.

#### **Recommendation III-3. Acknowledge The Failure To Credit NUI Utilities With A Proper Share Of The Value That UBS Should Have Paid For The IT Equipment It Acquired And The Intellectual Property That OAS Acquired Without Formal Transfer Of Payment.**

The transaction that Liberty is addressing in this recommendation occurred in 1998, well before ETG's most recent rate case. ETG agrees with Liberty that the transaction had "little" effect on ETG's rates, but disagrees with the recommendation.

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<sup>50</sup> *I/M/O Petition of NUI Corporation d/b/a Elizabethtown Gas Company for Approval of the Formation of a Holding Company*, BPU Docket No. GM00010067 (February 20, 2001), at 4, para. 5 (cited hereinafter as "Holding Company Order").



**Recommendation III-4. Clarify That Prudent And Reasonable ETG Utility Operating Costs Exclude Significant UBS Price Increases Or Termination Fees; Verify That Acceptable Performance Standards Language Exists In Any Agreement Submitted For BPU Approval.**

This recommendation is based in part on Liberty's earlier conclusion<sup>51</sup> that the service relationship between NUI Utilities and UBS required BPU approval. NUI disagrees; however, NUI Utilities has drafted and executed a service agreement with UBS, and filed the agreement with the BPU for either its approval or a declaration that such approval is unnecessary. As directed by the Board's Staff, NUI Utilities shared early drafts of this agreement with Liberty and incorporated virtually all of Liberty's suggestions in the final agreement. However, NUI Utilities does not believe that Liberty's suggestions concerning the rates paid under the agreement or the early termination provisions were based on any analysis other than Liberty's subjective views. More significantly, however, it is not necessary for the BPU to determine whether any costs incurred under the UBS agreement should be included in NUI Utilities' rates in order to approve the service agreement.<sup>52</sup> In its petition to the BPU concerning this matter, NUI Utilities has made it clear that it is not seeking approval of any rate treatment with respect to the costs incurred under the agreement; the reasonableness of those costs may be examined in a future rate case, if any such case is filed.

Liberty states that increases in UBS charges to ETG should be limited to 3% per year, using 2002 as a base year. Neither a 3% cap, nor the use of 2002 as a base year has any factual support. In fact, in 2002 there were significant investments made by UBS for a new mainframe computer, disaster recovery services and other outside services. UBS also incurred substantial increases in pension and insurance costs, and other costs. These cost increases formed the basis of the fee charged in 2003. For now, these charges are being absorbed by ETG, since they were not test year expenses during the last rate case. In the course of the next rate case, whenever it occurs, the overall prudence and reasonableness of the UBS

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<sup>51</sup> Audit Report at III-25.

<sup>52</sup> Indeed, in cases where the Board approved management service agreement under *N.J.S.A. 48:3-7.1*, it has made clear that it was not approving any particular rate treatment. See, e.g. *I/M/O The Petition Of United Water Vernon Hills, Inc. And United Water Hampton, Inc. For Renewal And Amendment To Management And Service Contracts With United Water Mid-Management And Service Contracts With United Water Mid-Atlantic, Inc.*, 2003 N.J. PUC LEXIS at \*4-5 (March 6, 2003).

or other billing costs could be reviewed. But neither Liberty nor the BPU is in a position now to say that any allowance should be limited to a 3% increase.

NUI Utilities believes that it can demonstrate that the rates paid to UBS under the proposed service agreement are objectively reasonable as compared to other utilities' costs for obtaining similar services. In other words, NUI Utilities believes that the rates set forth in the proposed UBS service agreement are no greater than fair market value. While Liberty is correct that NUI Utilities has not sought proposals from third parties to provide UBS's services, NUI Utilities has examined UBS's costs, UBS's rates for services provided to third parties, and the costs reported by other utilities for similar services, and believes that UBS's proposed rates are comparable to these market indicators. The BPU's regulations governing the provision by related competitive business segments of a public utility holding company of services produced for sale on the open market by the related competitive business segment of a holding company provide that any such services sold to an affiliated gas utility shall be priced at "no more than fair market value."<sup>53</sup> Applying this standard in the present case, it is clear that Liberty's subjective opinion of UBS's rates should be rejected. The only appropriate standard to be applied in resolving any future request by NUI Utilities to recover costs incurred under the UBS service agreement would be whether such rates are no greater than fair market value.

**Recommendation III-5. Account For The Excess WINS Development Costs Included In ETG Rates.**

NUI agrees with Liberty's statement that the issues of WINS conversion costs involved a nominal amount that did not likely affect the outcome of the last rate case.

**Recommendation III-6. Terminate The Practice Of Margin-Based Pricing By OAS For Utility Services.**

NUI Utilities has terminated its current relationship with OAS and has outsourced the OAS functions to a non-affiliated third party.

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<sup>53</sup> See *N.J.A.C.* 14:4-5.5(t)(2).

**Recommendation III-7. Require ETG To Refund To Customers The \$300,000 By Which ETG's Allocations Of NUI Corp. Costs Were Inflated Due To The Failure To Make Allocations To TIC.**

NUI disagrees with this recommendation, but in the interest of resolving this issue, agrees to refund to customers the recommended amount as part of an overall settlement. On the other hand, if settlement is not possible, then NUI requests that this issue be included with those set for hearing.

**Recommendation III-8. Require ETG To Refund To Customers The Amount By Which ETG's Allocations Of NUI Corp. Costs Were Inflated Due To The Failure To Make Allocations To Telecom.**

NUI disagrees with Liberty's recommendation, but in the interest of resolving the issue will agree to refund this amount to customers as part of an overall settlement. On the other hand, if settlement is not possible, then NUI requests that this issue be included with those set for hearing.

**Comments Regarding Chapter Five: Accounting And Controls**

**Recommendation V-1. Complete The Formalization And Approval Of Necessary Procedures.**

Liberty acknowledges that there has been "substantial progress" (Page V-46). NUI agrees to complete the formalization and approval of necessary procedures.

**Recommendation V-2. Take Appropriate Steps To Complete The Final Review Of The Cash Management Agreement.**

NUI agrees to take appropriate steps to complete the final review of the cash management agreement.

**Recommendation V-3. Correct Control Weaknesses In The Current Bank Accounts And Data Base.**

The issues discussed in this portion of the report were items that NUI brought to Liberty's attention as work in progress. NUI agrees to work to correct any remaining control weaknesses in the current bank accounts and data base. All the accounts with NUI's primary bank, Fleet, have been updated. All remaining items are a work in progress and will be completed shortly.

**Recommendation V-4. Conduct An Audit Of Continuing Property Records.**

NUI agrees with this recommendation and has added it to the list of audits to be conducted by Deloitte & Touche this year.

#### **Recommendation V-5. Assign A&G Overhead Cost To The Cost Of Construction.**

Liberty contends that administrative and general (“A&G”) overhead costs should be assigned to the cost of construction. This would be a change in BPU practice. ETG’s capitalization policy, where it does not capitalize A&G, has been stated in its Annual Reports to the BPU and in its last 4 base rate cases. No objection to this policy, which NUI believes is consistent with at least one other gas LDC in New Jersey, has ever been voiced by the BPU. A company-specific focused audit docket is not the place for the BPU, should it wish to do so, to announce new rate-making criteria that will likely affect other utilities. Moreover, it is not clear what the ultimate impact of capitalizing A&G would be on ETG’s rates, because while capitalizing would reduce A&G expenses, it would also increase rate base, return, depreciation expense and taxes. If the BPU believes that it is appropriate to address this issue, it should use rulemaking or generic evidentiary proceedings to explore possible policy changes that would have industry-wide effects.<sup>54</sup>

#### **Comments Regarding Chapter Seven: Corporate Governance**

##### **Recommendation VII-1. Require Common Meetings Of The NUI Corporate And The NUI Utilities Boards Until Completion Of The Sale Of NUI.**

The two boards have often met together over the last several months. The four outside Directors of NUI Utilities have also been attending all meetings of the Special Committee of NUI’s Board of Directors. Assuming that it is not Liberty’s position that the two boards should always meet as one – which would raise the question of why have two separate boards – NUI does not take exception to this recommendation.

#### **Comments Regarding Chapter Eight: Executive and Director Compensation**

##### **Recommendation VIII-1. Base Executive And Director Compensation On Comparisons With Similar Gas-Utility Holding Companies.**

NUI believes that its current executive and director compensation is appropriate. The NUI Utilities Board’s compensation has been adjusted to reflect the additional duties they have assumed. Liberty acknowledges that its recommendation is likely to be rendered moot.

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<sup>54</sup> See e.g. *Metromedia Inc. v. Director, Division of Taxation*, 97 N.J. 313 (1984).

**Recommendation VIII-2. Distribute The Costs Of NUI's Directors, Shared Executives, And Consultants On Executive Compensation In A Manner That Is More Equitable.**

As stated elsewhere, NUI is willing to consider changes to its allocation practices on a prospective basis.

**Recommendation VIII-3. Revise The Methods Of Compensating Directors.**

The NUI Utilities' Board's compensation has been adjusted to reflect the additional duties they have assumed.

**Recommendation VIII-4. Change The Measures Used For Incentive Compensation For Executives.**

The NUI Compensation Committee regularly reviews all aspects of executive compensation.

**Recommendation VIII-5. End Existing And Preclude The Use Of Future Consulting Contracts With Members Of The Board Of Directors.**

NUI's consulting agreement with its former CEO and Chairman concludes on March 31, 2004. NUI has no plans for additional consulting arrangements with Directors.

**Recommendation VIII-6. Require The Filing, Justification, And Approval Of Agreements Providing Severance Or Change-Of-Control Payments To Departing Holding-Company Executives And Directors.**

This proposal would have ramifications far beyond NUI. This is something for the BPU to consider as a general policy matter.

**Conclusion**

As explained at the beginning of these comments, the principal conclusions that the Board should draw from the Liberty report are that many important changes have been implemented at NUI, that throughout this process ETG's customers have continued to receive safe, adequate and proper service at just and reasonable rates, and that NUI should continue to find a buyer for the company. While there are many areas of disagreement between NUI and Liberty, there should be agreement that significant progress has been made with respect to the topics addressed in the Liberty report. NUI believes it has identified a clear path to an end result that will benefit all affected constituencies, and that process should continue.

NUI is committed to working with the BPU to achieve a settlement of all issues raised in the report. To echo a recent statement by President Fox in a matter involving Verizon-New Jersey: “By resolving this matter in a settlement rather than continuing to litigate . . . we were able to save both ratepayer money and agency resources . . . . Throughout this entire procedure, our foremost priority has been making decisions that benefit the ratepayers of New Jersey and help the BPU and Verizon move forward in the months and years to come.” Similar sentiments support a comprehensive settlement of the current proceeding. On the other hand, if a settlement cannot be reached then the BPU must be prepared to afford ETG limited expeditious evidentiary hearings to resolve disputed facts, and ETG also reserves its legal rights to challenge any BPU action.

Respectfully submitted,

NUI Corporation, NUI Utilities, Inc. and Elizabethtown  
Gas Company

Dated: March 26, 2004